

***Study on corporate governance index of Vietnam commercial bank –
the case of a newly established, medium to large
joint stock commercial bank***

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Abstract:

The paper aims at studying the corporate governance index applied in banks from literature review. By developing the corporate governance index (CGI) based on OECD, Basel principles, the authors suggest an index of corporate governance that could be applicable in Vietnam banks. The case of a bank –newly established, medium to large joint stock bank in Vietnam - will be used to test the appropriateness of this CGI. The results show that corporate governance index is able to reflect actual corporate governance situation of the bank and in line with its rank in size and performance efficiency (ROA) in 2010 and 2011. Transparency and disclosure is found to be the weakest. The detailed results of this CGI could be useful not only for the Bank's Board of Directors but also investors and policy makers. Implications includes (i)an suggestion to include more questions to evaluate quality of corporate governance, (ii) Scoring the CGI requires an indepth qualitative assessment, (iii) great efforts from policy makers, banks' directors should be made to improve transparency and disclosure.

Keywords :

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1. Background of research

The Vietnam banking system has experienced many changes since 2008. The change in ownership structure and governance is one of them. Establishment of joint stock banks, privatization of 3 large state owned commercial banks and issuance of new law on credit institutions in 2010 are milestones of the changing process. In this context, corporate governance in Vietnam banking system, an element which contributes to stability of the banking system, has been improved. Yet, bank governance is required to have fundamental change so that it can become a motive for sustainability and stability of the banking system.

Corporate governance of businesses is evaluated based on a framework such as OECD principles or measured by an index. Corporate governance index (CGI) has been used in many countries. Although methodology to calculate the index differs from countries to countries, the main purpose of CGI is to:

- monitor and identify companies which do not comply with corporate governance regulations. This index would help promote the transparency and soundness of the financial market.
- serve as a benchmark which facilitates the entry of companies into new market and international integration.
- monitor risks of companies.

In Vietnam, CGI has not been introduced. It is necessary to introduce this index in order to promote transparency and strength of the Vietnam banking system in the globalization process.

2. Related research and project

Two main types of CGI have been studied and built by researches and projects: (i) CGI built by individual country such as the United Kingdom, Japan, Singapore, Turkey, (ii) CGI of a group of countries such as CGI Euro, CGI of developed countries (ISS, FTSE, 2005). From index's content perspective, there is an index of certain area in corporate governance such as index of investors' right protection, index of disclosure and transparency (Marina, M. and Luc, R., 2005) and composite index such as GTI of Singapore (The business Times and CGIO, 2011).

In constructing an corporate governance index, there are two main approaches:

- First, CGI is built through a project joint between academic institutions. The result –

CGI index is published on the market and recognized by an authority such as Stock exchange commission. This type of index include indices of Malaysia, Singapore, (the Star online, 2010; the Business Times and CGI, 2011). The methodology to calculate and validate the index has been reviewed periodically (JCGRI, 2008). Principles to construct an index include independence, reliability and transparency.

- Second, corporate governance index is built in researches in studying the relationship between corporate governance and firm performance. However, these researches are for academic purposes (Pitabas Mohanty, 2011; Anlin Chen et. Al, 2007).

In principles, most CGI are measured based on corporate governance principles such as OECD principles. However, it is recognized from projects and researches that methodology to construct CGI differs in terms of measurement indicators and calculation method. For instance, Singapore CGI (GTI) has 21 indicators while CGI of a group of countries uses 49 indicators. This indicates that CGI depends on national conditions. Each country should have its own studies in CGI.

In Vietnam, there is a growing number of researches in corporate governance. Assessment reports of corporate governance in Vietnam (World Bank, 2006; N.D.Cung, Scott, R. 2005) have concluded that Vietnam has not materially observed most of OECD corporate governance principles; regulations in corporate governance have not been complied well in Vietnam. Q.M.Hao (2008) and L.C.Hoa (2009) have found that corporate governance has impact on firm performance. The state research project in building corporate governance index (2010) by T.N.Thang has proposed as set of indicators and methodology to calculate CGI for Vietnam.

In banking, researches in corporate governance mainly focus on qualitative assessment of actual practices. It is widely agreed that there is a big gap between OECD principles and regulation in bank governance in Vietnam. It is found that the board independence is weak, minority shareholders' rights are not well protected, disclosure and transparency is inadequate and inaccurate. It is also found that becoming listed and privatization has improved bank governance for the past few years. Together with OECD principles, Basel principles of enhancing corporate governance in banking have formed a framework for bank governance.

However, an assessment based on these principles is qualitative and it is not easy to make comparison of corporate governance among banks. Furthermore, proposed CGI construction method by T.N.Thang (2010) only covers corporate governance of companies in general which does not take into account specific regulations for banks. Like other countries, banking system in Vietnam is highly regulated compared to other businesses which makes bank governance differs substantially to other businesses. In this context, it is necessary to have a CGI for banks. In the study published in 2012 Economic Outlook Report, the authors have proposed a set of indicators and calculation method to construct a CGI and used them to construct CGI for all Vietnam banks. This work can be considered as the pilot on the large scale to test the feasibility to calculate CGI for banks for the first time. The result is good as information to build the index can be considered as adequate. It has shown the clear difference between corporate governance in Vietnam Banks and international standards in that the scores are substantially below the maximum level. However, in scoring the index, some indicators need to be modified and an indepth qualitative evaluation of individual bank CGI is needed in order to have some insights in appropriateness of CGI and in how each indicator is evaluated before deciding its score.

For the above reasons, the paper has modified the method to construct CGI for banks in Vietnam firstly introduced in March 2012 and tested this method by calculating CGI for one bank as a case study. Afterwards, appropriateness of this CGI is qualitatively evaluated.

3. Proposed CGI construction method

Based on method for CGI of all business (T.N.Thang, 2010), OECD principles and Basel principles for enhancing corporate governance (2006), modifications from the first test in March 2012, following CGI construction method for banks is proposed.

There are 60 questions which cover 5 main components:

- Shareholders and general shareholders' meeting (18 questions)
- Board of directors (20 questions)
- Supervisory board (8 questions)
- Disclosure and transparency, auditing (12 questions)
- Violations (2 questions)

Questions are designed to be straight forward and marked based on marking scale in appendix 1. The maximum score is 100. If banks are found to have any violation of regulations, their scores will be deducted.

Table 1: Scoring scale

<i>Component</i>	<i>Point</i>
Shareholders and general shareholders' meeting	37
Board of directors	34
Supervisory board	8
Disclosure and transparency, auditing	21
Violations	-2

In this paper, a bank (the Bank) is selected for scoring based on the following consideration:

- It is a newly established bank as it was established in 2008, right after privatization started.
- The new law on credit institutions (2010) will have substantial impact on operation of newly established banks.
- Its capital ranked among top 12 biggest banks and asset ranked among 20 biggest banks out of 44 Vietnam banks.
- Its performance (ROA) ranked among top 20 banks.

With these characteristics, the bank selected will not be affected by the management style of a centrally planned economy and strongly influenced by the management style of a market economy after privatization. The bank is a medium to large joint stock commercial banks in Vietnam. For these reasons, corporate governance of the bank is expected to be more in line with international practices and better comply with banking regulation in Vietnam. The bank is expected to be of more disclosure and transparency so that information about the bank is adequate to calculate CGI.

Secondary information and data of the bank includes the bank annual report, audited financial reports, reports and other materials in general shareholders' meeting (GSM), other information from the bank website and other related websites. Primary data includes discussions with investors and experts. With this information, CGI of the Bank has been calculated for 2010 and 2011.

4. Results and discussion of results

Overall assessment of CGI score in 2010, 2011

The 2010 CGI of the bank is 52/100 and the 2011 CGI is 53/100. The bank's corporate governance has been slightly improved in that number of independent directors increased from 2 to 3 directors. All other information is unchanged. With this result, the bank ranked among top 20 banks in corporate governance in 2011. This rank is in line with the rank of its ROA and asset size. Compared to OECD, Basel principles and SBV regulation, the bank just observed half of them (52/100). The gap between actual practices and the principles, regulations is substantial but it can be seen that effort has been made to improve its corporate governance.

Table 2. The Bank CGI

<i>Component</i>	<i>2010</i>	<i>2011</i>
Shareholders and general shareholders' meeting	22/37	22/37
Board of directors	16/31	17/34
Supervisory board	5/8	5/8
Disclosure and transparency, auditing	9/21	9/21
Violations	0	0

Assessment of component scores

Score of shareholders and shareholders' meeting is 22/37. This is just above average. Score of board of directors is 16/34 (2010) and 17/34 (2011), just as half of maximum score. Same as these two component scores, supervisory board's score is just above average – 5/8. Thus, there is almost no difference among these 3 component scores and just at half of maximum score. This indicates that there is substantial gap between actual practices of the bank in shareholders, board of directors and supervisory board and OECD and Basel principles. Three components are all at the same level.

In contrast to the above components, transparency, disclosure and auditing is found to be the weakest. Its score is 9/21, much lower than the average and score of other components. This weakness comes from 2 main sources: (i) financial reports are prepared based only on Vietnam accounting standard – much lower than international standard, (ii) numbers and frequency of disclosed reports and information about financial conditions, operation and especially internal or third party transactions are limited and substantially less than required. Further qualitative assessment of various information sources supports this score as there is a cross lending in the bank which investors cannot find this information easily. One of the main shareholders of the bank has borrowed from the bank a loan which has value far exceeding its

shares at the bank. This kind of information is hardly found on official or main websites such as bank's website or Stock exchange commission's website while it can be found from other sources which are scattered and difficult for small investors to find such as websites related to securities or informal discussions with big investors. There are too many websites related to finance and stock exchange for investors and public to go into all of them. Furthermore, it is not always easy to have opportunities to discuss with big investors if you don't have any relations with them.

The limitations in disclosure and transparency has led to the situation that as investors find difficult to get information about the bank from official sources, they tend to go to unofficial sources to get the information. This phenomena has become increasingly common so that unofficial information has become more important in the eyes of many investors and therefore have more influential impact on investors' behaviour. If this situation is not controlled, it will have detrimental impacts on the market:

- Investors' confidence in the regulators and financial system will decline overtime if information from unofficial sources is found to be true later.
- Risks in financial system will increase and even become out of control if these unofficial sources of information are used to spread information for bad purposes.

As mentioned above, disclosure and transparency is the weakest area in corporate governance of the bank compared to shareholders, board of directors and supervisory board. This difference in 4 component scores is supported by a further qualitative analysis. Vietnam banks tend to have almost guidelines or policies required by central bank in place. These guidelines covers issues exactly as required by central bank. But implementation of these policies is not always in line with policies. This violation can easily be covered by banks especially when enforceability of regulation in Vietnam is weak and supervision has limitations. In disclosure and transparency, it is the information made known to the market to be evaluated. Therefore, it is difficult for banks to cover this problem.

5. Conclusion and implications

Conclusion

CGI of the bank is found to be able to reflect corporate governance of the bank. Component score of disclosure and transparency better reflects

actual situation of the bank. However, for three components (i.e. shareholders, board of directors, supervisory board), questions should be refined so that they are able to better measure quality of these components.

It is found that even for a medium to large bank, established after privatization and unaffected by state management style under centrally planned economy, its corporate governance just observed half of OECD, Basel principles and central bank's regulation. This result indicates that a lot of effort has to be made if Vietnam would like to really integrate into the international financial system.

Transparency and disclosure is the weakest in the bank's corporate governance. This weakness is not difficult to identify but if no measures are taken timely, it will have detrimental impact on confidence of the investors in regulators and government policies. It will also bring about an increase in risks as unofficial sources of information is having more influential impact on investors' behaviours.

Implication

The above observation brought about an implication for constructing CGI. For three components (i.e. shareholders, board of directors, supervisory board), it is necessary to have a thorough qualitative evaluation before deciding the point for each question. In addition, questions for these components should be further review to better measure the quality of corporate governance.

In banking system, disclosure and transparency should be enhanced in terms of both quantity and quality of information. This can be achieved by reviewing and changing current policies and enhancing their enforceability. The role of unofficial sources of information should be reduced.

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Reports on operation and financial condition (2010, 2011).

Appendix 1

No.	Description	Points	Remarks
SHAREHOLDER AND SHAREHOLDERS' MEETING (Maximum 37 points)			
1	If there are shares held by foreign individual and institutional investors	1	
2	If the bank has intention and plan to go listed (For unlisted banks)	1	
3	If the bank has plan to be listed on international market	1	
4	The benchmark of proportion of shares for a large shareholders is 5%.	1	
5	Shareholders can transfer their shares to others without restriction	1	
6	The bank's charter is fully complied with central bank regulations	1	
7	The bank's governance policies include: <ul style="list-style-type: none"> - Procedure to convene and vote General shareholders' meeting. - Procedure to propose, nominate and terminate BOD members. - Procedure to convene BOD meetings. - Procedure to nominate and terminate executive positions. - Procedure to cooperate among governance units of the bank - Performance evaluation and bonus policy for governance units of the bank 	1 1 1 1 1 1	
8	Time of GMS meeting after the financial year end <ul style="list-style-type: none"> - ≤ 2 months - > 2 months and ≤ 4 months - > 4 months 	2 1 0	
9	Invitation for GMS meeting is sent prior to date of meeting: <ul style="list-style-type: none"> - ≤ 10 days - 11 days – 20 days - > 21 days 	0 1 2	
10	If the bank does not have a minimum requirement for numbers of shares held by investors for shareholders to be eligible to attend the meeting	1	
11	Information about GMS meeting is conveyed to shareholders by <ul style="list-style-type: none"> - Letter to shareholders - Website - Newspapers 	1 1 1	
12	The bank has guidelines and policy for GMS	1	
13	The bank provides information about voting procedures and rules: <ul style="list-style-type: none"> - To shareholders - Public media - Both 	1 1 2	
14	Shareholders can vote through their representatives	1	
15	Accumulative voting is applied in GSM	1	
16	Reports of the board of directors include: <ul style="list-style-type: none"> - Report on bank operation and performance - Report on supervision of bank operation and financial conditions. - Report on supervision of BOM and executive staff - Evaluation of the cooperation among BOD, supervisory board, BOM and shareholders - Others 	1 1 1 1 1	
17	Reports by supervisory board at GSM include: <ul style="list-style-type: none"> - Operation and performance of supervisory board - Meeting results and decisions of supervisory board - Report on supervision of operation and financial conditions of the bank - Report on supervision of BOD and BOM - Evaluation of the cooperation among BOD, supervisory board, BOM and shareholders - Others 	1 1 1 1 1 1	
18	GSM's resolution are published on the bank website	1	
BOARD OF DIRECTORS ((Maximum 34 points)			
19	The ratio of non executive and independent directors to total BOD members is: <ul style="list-style-type: none"> - ½ - > 1/2 	1 2	

No.	Description	Points	Remarks
20	Number of independent directors: - ≤ 2 - > 2	1 2	
21	Information on qualification, training and experience of BOD members is: - Published on website or on public media - Informed in GSM - Both on website or public media and GSM - Not disclosed	1 1 2 0	
22	Chairman is independent director	1	
23	BOD has following committees: - HR committee and Risk management committee - HR committee, Risk management committee, others	1 3	
24	The bank has following procedures: - Selection, nomination and termination of BOD members - Selection, nomination and termination of executive officers.	1 1	
25	Profile of BOD candidates are notified to shareholders before GSM	1	
26	BOD member has informed their commitment of integrity, accuracy and relevance of information provided	1	
27	Term of board members are not the same	1	
28	Minutes and resolution of BOD is published	1	
29	There is published information which help evaluate competency and independence of member of audit committee or internal audit department	1	
30	The bank has its secretary or secretariat to BOD	1	
31	The requirement of shares held by a shareholder to become BOD candidate is 5% and less than that.	1	
32	The bank has code of ethics	1	
33	Performance of BOD members are evaluated	1	
34	The bank has: - Back up personnel plan - Disclosed number of board meetings in a year - Disclosed attendance of BOD members in the year - Disclosed responsibilities of each board member - Provided training to board member - Buy insurance of responsibility for board member	1 1 1 1 1 1	
35	Remuneration for board member is based on: - Financial performance - Behaviours in fulfilling their duties - Both financial performance and behaviours	1 0 1	
36	BOD is independent in deciding management's remuneration.	1	
37	Remuneration for BOD is: - Cash - Common share - Preferred share	1 1 1	
38	The bank discloses the following information in GSM: - The whole remuneration for BOD - Remuneration of each member - Plan for the coming year's remuneration	1 1 1	
SUPERVISORY BOARD (Maximum 8 points)			
39	There is information for shareholders to evaluate training background and experience of supervisory board members.	1	
40	Supervisory board members have commitment of business ethics	1	
41	Supervisory board has their own procedure in order to implement their duties independently	1	
42	The bank has procedure and policy in nominating and terminating supervisory board members.	1	
43	Supervisory board has their own operation policy.	1	

No.	Description	Points	Remarks
44	The number of meetings per annum of supervisory board is disclosed	1	
45	Supervisory board members are paid based on their performance	1	
46	The bank provides training to supervisory board members.	1	
TRANSPARENCY, DISCLOSURE AND AUDTING (Maximum 21 points)			
47	The bank prepares financial reports based on: <ul style="list-style-type: none"> - Vietnam accounting standard - International accounting or reporting standard - Both 	1 1 2	
48	The bank discloses: <ul style="list-style-type: none"> - Unaudited financial reports quarterly and yearly - Audited annual financial reports - Consolidated reports and bank reports - Annual report - Internal transactions - Third party transactions 	1 1 1 1 1 1	
49	The bank has disclosed financial reports <ul style="list-style-type: none"> - Monthly, quarterly, annually - Quarterly, annually 	1 1	
50	The bank discloses financial reports and annual report on time as specify by central bank	1	
51	The bank gives explanation for late disclosure of above reports	1	
52	The bank gives explanation for differences (if any) between unaudited financial report and audited financial report.	1	
53	The bank has : <ul style="list-style-type: none"> - its own website and updated continuously - in English 	1 1	
54	Communication with shareholders is done through: <ul style="list-style-type: none"> - Shareholders' newsletter - Shareholders' meeting - Others 	1 1 1	
55	The external auditor is among big four (E & Y, PWC, KPMG, Deloitte Vietnam)	1	
56	The bank has procedure for selecting external auditor	1	
57	The bank has policy to change external auditor	1	
58	The bank actually changes external auditors at least every 5 years	1	
VIOLATIONS			
59	There is evidence for violation related to information disclosure	-1	
60	There is evidence for violation related to audit	-1	